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Income Tax Basis for a Remainder Interest

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Income Tax Basis for a Remainder Interest

-by Neil E. Harl*

Although less common than a half century ago,¹ it is not at all unusual to see use made of legal life estates and remainders, not to mention life estates and remainders in trust. A major concern is what is the income tax basis for a remainder and what happens if the holder of the life estate predeceases the remainder interest holder? Is the holder of the remainder interest entitled to receive a new income tax basis at death?

The concept of a "uniform basis"

The regulations have made it clear for years that the income tax basis of property acquired from a decedent² is uniform in the hands of every person having possession or enjoyment of the property at any time under the will or trust (or other instrument) or under the laws of descent and distribution.³ That concept, of a "uniform basis," means that the basis is the same and is uniform whether the property is possessed and enjoyed by the executor or administrator, an heir, a legatee or devisee or the trustee or beneficiary of a trust created by a will or inter vivos trust.⁴

Under the uniform basis rules, the available basis is allocated between and among the property held in a life estate or estates and the remainder interests.⁵ Factors are provided, based on life expectancies, for use in determining the income tax basis of the life interest, the remainder interest or the term interest in property on the date the property interest is sold.⁶ The income tax basis of the life interest, the remainder interest or the term interest is computed by multiplying the uniform basis (adjusted to the time of sale) by the appropriate factor. For the taxable disposition of a life interest or a remainder interest, the factor used is the appropriate factor appearing in the tables opposite the age (on the date of sale or other disposition) of the person whose death the life interest will terminate.⁷

New basis for remainder?

If a remainder holder dies before the death of the holder of the life interest, does the remainder holder receive an adjustment in income tax basis? As is widely known, *granted* life estates are not included in the gross estate of the holder of the life estate and holders of such life estates do not receive a new basis at death. As for remainder holders, the regulations⁸ dealing with the bequest, devise or inheritance of a remainder interest, state –

"Where property is transferred for life, with remainder in fee, and the remainderman dies before the life tenant, no adjustment is made to the uniform basis of the property on the death of the remainderman."⁹

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The regulation goes on to state that the successor's basis for the property interest is determined by adding to (or subtracting from) the adjusted uniform basis assigned to the remainder interest the difference between the value of the remainder interest included in the remainderman's estate, and the basis of the remainder interest prior to the remainderman's death.¹⁰

An example in the regulations¹¹ shows how that calculation is handled.

Remember, for the distribution of property of decedents, all titles to property acquired by bequest, devise or inheritance relate back to the death of the decedent, even though the interest of the person taking the title was, at the death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory or otherwise.¹²

So what happens at the death of the remainder holder after the death of the life tenant?

In a case that arose before the regulations¹³ became final, the taxpayer had acquired an interest from a remainder holder with a life estate held by the grantor's spouse.¹⁴ The question was the taxpayer's basis on sale of the property interest. The court determined that the value related to the fair market value at the death of the decedent-remainder holder from whom the taxpayer had acquired the property interest, not the value when the original testator died.

However, the current regulations, as noted above,¹⁵ state that the basis of the remainder holder's heir, legatee or devisee for the remainder interest is determined by adding (or subtracting from) the part of the adjusted uniform basis assigned to the remainder interest the difference between the value of the remainder interest included in the remainderman's estate and the basis of the remainder interest immediately prior to the remainderman's death.¹⁶ Those regulations became final in 1957.¹⁷

Of course, if the transfer was created by gift, the basis is derived under gift rules in terms of the income tax basis.¹⁸

ENDNOTES

¹ See Harl, "Hazards of Basing an Estate Plan on Successive Life Estates," 20 *Agric. L. Dig.* 137 (2009). See generally 8 Harl, *Agricultural Law* §§ 62.02, 43.02[6] (2009); Harl, *Agricultural Law Manual* § 5.02[4] (2009); 1 Harl, *Farm Income Tax Manual* § 3.20[4][1][i][F] (2010 ed.).

² See I.R.C. § 1014(a).

³ Treas. Reg. § 1.1014-4(a)(1). See *Pierson v. Comm'r*, 253 F.2d 928 (3d Cir. 1958). See also *Dyer v. Comm'r*, T.C. Memo. 1961-141 (basis of stock fixed at fair market value on March 1, 1913 and not at death of life tenant).

⁴ Treas. Reg. § 1.1014-4(a)(1).

⁵ Treas. Reg. §§ 1.1014-4(a), 1014-5.

⁶ Treas. Reg. § 1.1014-5(a)(3).

⁷ *Id.*

⁸ Treas. Reg. § 1.1014-8(a)(1).

⁹ Treas. Reg. § 1.1014-8(a)(1).

¹⁰ *Id.*

¹¹ Treas. Reg. § 1.1014-8(b).

¹² Treas. Reg. § 1.1014-4(b).

¹³ Treas. Reg. § 1.1014-8(a).

¹⁴ *Bauer v. United States*, 168 F. Supp. 539 (Cl. Ct. 1958).

¹⁵ See note 9 *supra*.

¹⁶ Treas. Reg. § 1.1014-8(a)(1).

¹⁷ T.D. 6265, Nov. 6, 1957.

¹⁸ I.R.C. § 1015.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

FEDERAL TAX

DISCHARGE. The debtors, husband and wife, did not file returns or pay taxes for 2000 through 2004. The debtors filed for Chapter 11 in March of 2006, which was dismissed in November 2006. The debtors filed a second Chapter 11 case in September 2007 and that case was dismissed for bad faith in December 2007. A creditor filed the current involuntary Chapter 7 case in February 2008. In June 2005 the IRS issued the Debtors Collection Due Process Notices of Intent to Levy for all tax years. The debtors filed requests for collection due process hearings, some of which were later withdrawn. The debtors argued that their taxes for 2000

through 2004 were dischargeable because the returns were due more than three years before the filing of the petition. The court held that the running of the three year period was tolled during the prior bankruptcy cases and during the time, plus 90 days, that the requests for collection due process were active. After removing these tolled periods, the petition was filed within three years of the tax returns for the tax years; therefore, the taxes were nondischargeable. *In re Abir*, 2010-1 U.S. Tax Cas. (CCH) ¶ 50,201 (E.D. N.Y. 2010).

In a Chief Counsel Advice letter, the IRS ruled that some tax claims are not discharged in a general Chapter 13 discharge: (1) employment taxes withheld from employees' wages; (2) taxes for which no return was filed or for which a return was late-filed within two years before the petition date; and (3) taxes for which the debtor filed a fraudulent return or willfully attempted to evade or defeat taxes. Also nondischargeable are tax debts where the debtor fails to